DOW THEORY LETTERS INC.

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THE MARKET: July is the month when the stock market "normally" provides a show of strength. In July mid-year investment funds are "put to work," and this year the expectation for a substantial rally was even greater than usual because many large financial interests (funds) were in a fairly liquid position with large amounts of cash to spend. Furthermore, this July was deemed to be a "month for strength" because the market was already down and sold-out, with many stocks selling at 10% to 50% under their highs of the past year or so. But July proved a disappointment this year; no rally worthy of the name materialized.

In bad (i.e. bear market) years when no real summer rally is generated, September and October are the months to watch. For it is then that the demand for money (for non-investment purposes) increases sharply. This September and October should prove doubly interesting, because already our nation is laboring under a massive money squeeze, and the squeeze is becoming more acute daily. Listen to this appraisal of the situation from the latest (August 10) Janeway Service: "MONEY SQUEEZE: From crisis to panic. During the recent phase of the crisis, new sources of money failed to open up to meet demand. During the approaching phase of panic, heretofore available supplies of money will dry up--not only for the public but for its institutional sources of money. The process of reciprocal liquidation between bank borrowers (whose loans will be called and whose lines of credit will be cancelled) and banks, whose deposits will be withdrawn, will coincide with the build-up of autumn liquidation pressures on the stock market....."

Last week the yield on the D-J Municipal (tax free) Bond Index rose to 4.3% highest since 1934. The Federal Fund rate (the interest banks charge on loans to each other) rose as high as 6%, while on August 16 a few New York City banks led a boost in the prime rate (the rate charged to the top-graded bank customers) to 6%. A new issue of Amer. Telephone AAA debentures remained one-third unsold and sank in price on the open market to 98 to yield 5.75%, highest in Telephone history. On August 15 the 91-day Treasury bills were auctioned to yield a whopping 5.04%, a record high yield for the bills. Perhaps the most ominous facet of the monetary situation is the fantastically high loan-to-deposit ratio of the leading N.Y.C. banks. Whereas a few years ago a L-D ratio of 50 to 60 was considered high, 13 big N.Y.C. banks last week showed a L-D ratio of 78.2%, which means that 8 out of every 10 dollars deposited with these banks was out on loan. In order to raise additional funds, the banks are dumping bond from their portfolios at substantial losses, thus putting more pressure on the already reeling bond markets. What will happen during September

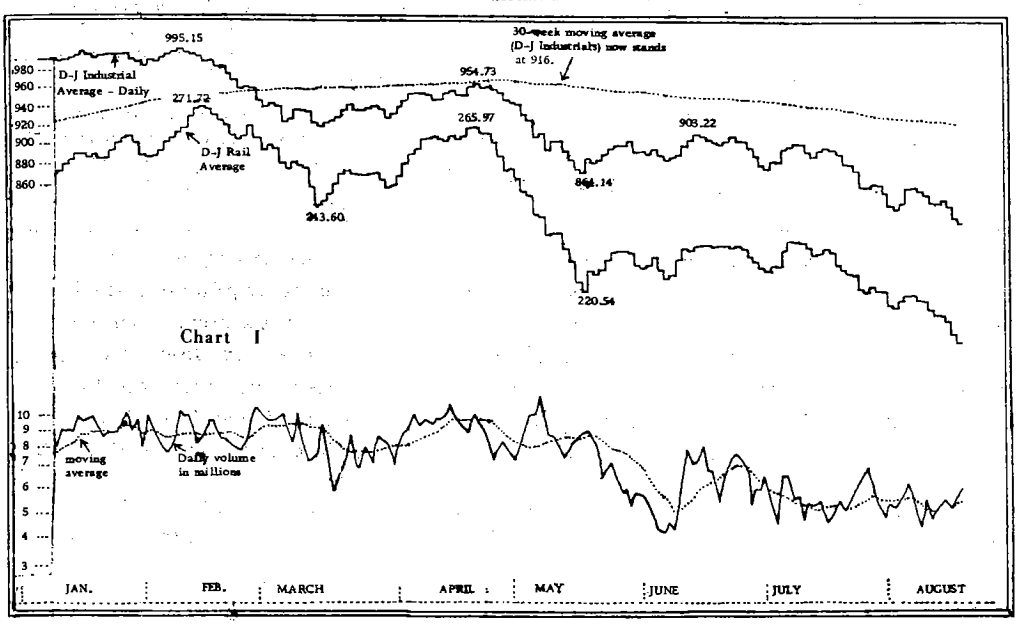
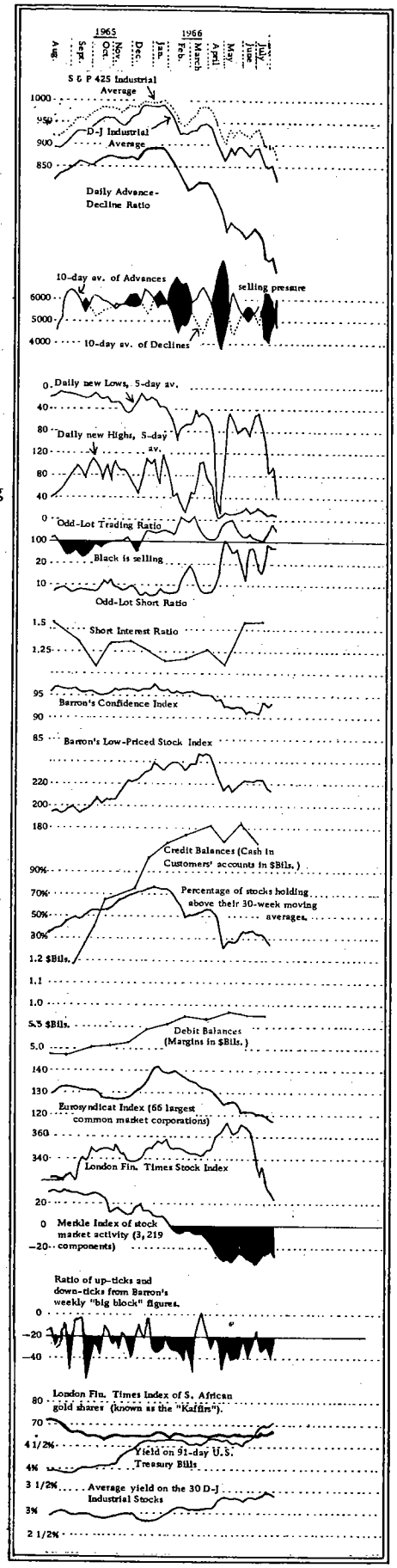


Chart I


1965
1966
S & P 425 Industrial Average
D-J Industrial Average
Daily Advance-Decline Ratio
10-day av. of Advances
selling pressure
10-day av. of Declines
Daily new Lows, 5-day av.
Daily new Highs, 5-day av.
Odd-Lot Trading Ratio
Black is selling
Odd-Lot Short Ratio
Short Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Credit Balances (Cash in Customers' accounts in $Bils.)
Percentage of stocks holding above their 30-week moving averages.
Debit Balances (Margins in $Bils.)
Eurosyndicat Index (66 largest common market corporations)
London Fin. Times Stock Index
Merkle Index of stock market activity (3,219 components)
Ratio of up-ticks and down-ticks from Barron's weekly "big block" figures.
London Fin. Times Index of S. African gold shares (known as the "Kaffirs").
Yield on 91-day U.S. Treasury Bills
Average yield on the 30 D-J Industrial Stocks

 to November of this year when loan demand expands seasonally?

Last week I went through my historical chart book of the Averages and checked every year in which a primary bear market was in effect during the last half of the year. The record is not a happy one. In 1899 there was a November-December crash. In 1902 the market headed down during September-December. In 1907 the market caved in during July to December. In 1909 September to November brought in weakness. In 1912 the market was lower from October to December. The following year, 1913, saw September-December weakness. In 1917 the market fell sharply from June to December. 1920 brought a cave-in during September to December. In 1937 the full brunt of the collapse came in August-December. 1939 was bad during August-December. 1940 saw a November-December drop. In 1941 the market fell in July to December. 1946 witnessed an August-September bear market collapse. 1948 brought in October-November weakness. More recently, during severe corrections (some term them bear markets) 1957 saw severe July-December weakness. 1960 also saw August-October weakness. 1962 ended with a violent sell-off during August to October. All in all, the record does not bode well for bear markets during the September-December period. 1966 could well conform to the historical record.

As I write this the bear market appears eager to "jump the gun" on the calendar. On August 15 the Industrial Average confirmed the prior indications of the Rails, smashing through the August 2 low to establish a new low for the bear market. I want to state again for my many new subscribers that neither the duration nor the extent of a primary movement can be predicted in advance. Primary movements are a law unto themselves. They do not end at the technicians' "projected level," they do not end at preconceived "support points," rather they end when the great primary force is exhausted for the move. Where is "exhaustion" for this leg of the bear? Is it at 820, 750, or 650. There isn't a man, a service or an organization alive that has the faintest idea. I feel (as I have all along) that the market is getting closer and closer to the "crash" stage. In 1962 the crash stage encompassed around 100 points. That was a reaction in a bull market, however, and the Averages subsequently retumed to new record highs. But this is a primary bear market, and if I had to guess, I would say that the potential coming crash could carry further than 100 points. If the crash were to begin now, it could easily take the Dow under 700.

NOTES & QUOTES: Since most of my subscribers hold S. African gold shares and since the political (racial) question is a factor in investing in S. Africa, the following should be of interest. Rhodesia, the nation bordering on S. Africa's northern border, has to all intents and purposes won her battle for independence. Had the white Smith cabinet folded under British pressure and sanctions, the implication would have been that S. Africa too might have been brought to its knees under economic pressure. But it is Britain that has given in, not Rhodesia, and this is an element of strength in any cold appraisal of S. African political stability.

It is now obvious that the white Rhodesian government will not be toppled by economic sactions, U.N. action or opposition from any of the surrounding black African nations. Britain, de facto, already recognizes Rhodesia, since it is now negotiating with the Smith cabinet on a number of levels. Despite their public protestations, neighboring black African states are now trading freely with Rhodesia. Britain's Wilson would not have used force against Rhodeisa. Now it appears that he is ready to drop the sanctions against Rhodesia. Britain's staggering economy cannot stand the onus of sanctions, which are costing Britain more than they are costing Rhodesia.

Before long S. Africa and Portugal will recognize Rhodesia. France and Spain will probably follow. Malawi and Bechuanaland of the African states will be next, and in the end a federation between Rhodesia and S. Africa will probably develop. This whole outcome is about what I predicted when many were selling their S. African gold shares because of the "coming blow-up" in Rhodesia and S. Africa. Here is the moral of the tale: where there is economic strength, there is usually political strength. Where there is economic and political strength, there is usually stability.

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From the August 6 London ECONOMIST: "Equity investors who are trapped now have to dig in for a long period or take the ultimate in courage, by selling on the argument that the index will fall at least another 15% and conceivably more before it gets better.....The basic economic prospects were already poor when the market was hitting its high at the beginning of July. Earnings were turning down, companies were becoming increasingly strapped for cash .....As the world was becoming increasingly short of capital, interest rates were rising fast. Wall Street took a dive and Frankfort was never gloomier. No-one can decently mention growth as a prop for the market; at the best, the current prospect looks more like the middle thirties for those who are old enough to remember that dreary period."

* * * *

On top of the $12 billion already budgeted for Vietnam (in a total defense budget of $58 billion), Pentagon planners now expect to ask Congress for an additional incredible $10 to 15 billion for Vietnam. The additions will be needed to cover ordinance and stepped-up draft costs, as well as aircraft losses. Washington now admits that 400 planes have been lost in the last 18 months, and at least that many have been badly damaged.

From Jean Raffaelli, the only Western (French) correspondent in Hanoi and a correspondent for NEWSWEEK: "Hanoi will not capitulate. It is ridiculous to hope to 'drag them to the negotiating table.' The North Vietnamese are ready, in case of further escalation to take to the bush, to abandon their cities." (Newsweek, Aug. 15).

* * * *

From the New York Times, Aug. 10: (We might call this, an addition to our "He who laughs last" collection)..... "The final figures for 1965 showed that France took in $962 million more than she spent abroad -- a seven year record. And the Bank of France monthly report discoled that up to Aug. 1 this year, $508 million more had been added to the reserves, bringing them to a grand total of $5.96 billion.....The figures mean that France nowadays enjoys the strongest payments surplus in the world and, next to the U.S., holds the largest hoard of gold--$5.16 billion."

* * * *

BONDS: What about the bond market? There is no questioning the fact bonds are now attractive judged by recent history. This generation has never seen anything like it. Is it going to get worse (are bond yields going higher)? I believe yields are going higher, but I would not venture to say how high. Would I buy bonds now? Here is how I feel: subscribers with substantial assets might now start nibbling at the highest rated bonds in the full realization that they are not attempting to call the bottom and in the realization that they might be a year or so off in their timing. I feel that if one has a potential $200,000 earmarked for bonds, one might now purchase the first batch of $25 to $50 thousand during the coming few months.

I received a letter yesterday from a veteran market observer, a man for whom I have great respect (he is now a fund manager). Although he is a bit more optimistic than I am about the bond market, I feel that his perceptive comments are worth repeating here: "Bond yields are simply sensational. One has to go back to the inflation of the post-World-War I period to find their equal. Admittedly the bond yields of today may become even juicier in future months, but in this general area a fund which has been concentrating for years on short maturities in its bond list may now well consider going out longer. It is, of course, of paramount importance in doing so to consider the call feature. The whole point is to latch onto some of these marvellous yields while they are available, and to do so in such a way that they will continue to feed income into the fund for a decade, or two, or three.

"The greatest bargains, of course, are in short-term obligations. Certain government agencies have already afforded yields of practically 6%. Just today there appeared an issue, for private placement, of $50,000,000 first mortgage bonds of the Philadelphia Electric Company, 6% coupon, at par, maturing in 1968-72. The rating is AAA. Short-term bonds can naturally be considered as a source of funds for the purchase of common stocks at some time in the not-too-distant future."

PRIMARY TREND: During a primary bear market the trend of stocks, commodities, real estate businesses, household articles, everything, tends to go down. The deceptive part of a bear market is the manner in which "things" go down. If, for the sake of

argument, we possessed a crystal ball, and that ball told us that the Industrial Averages was going from its February, 1966, high of 995 to a 1968 low of 400, we would certainly stay out of the market until 400 was reached in 1968. By the same token, if the Dow was going from 995 to 400 in an almost straight line decline, it would not matter whether we knew when the Dow was going to hit bottom, nor would it matter whether we knew 400 was to be the bottom. The drop would be dramatic but what would keep us bearish would be the steady straight line decline. Each week would look worse than the last week, and the trend would be so clear that only an idiot would refuse to "get off the track."

Unfortunately, the market does not work that way. No one knows what the final low figure for the Dow in this bear market is to be, and no one knows when the final low figure will be recorded. To make matters more difficult, the market continues to be deceptive. It continues to provide "hopeful" rallies, it refuses to turn the majority of investors and amateur share owners bearish. What will ultimately turn Wall Street bearish? First, an all-out crash would obviously generate great pessimism. Second, a slow but relentless erosion of values would bring about deep gloom.

Will this bear market produce a crash, will it continue to erode away as it has done since the February high, or will it build a base for a late-summer or fall rally? My own feeling is that time is working increasingly in favor of the "crash" thesis. Six months have passed since the February bull market peak, the Dow is now down around 180 point, and some of the deteriorating fundamentals are beginning to be apparent. It would be a waste of subscribers' times to go into details about the airline strike, the probabilities a new tax increase, tight money, lagging auto sales, controls, a step-up in the Viet Nam war, etc. These and many other new factors are clear enough. Nevertheless, this bear market has been fairly "polite" so far in that it has not produced panic, and it has not shaken complacent stockholders loose from their shares. In due time, the politeness should wear off, and the true vicious bear should come out of hiding. When this happens, the public's strongest emotion--fear--will reign. Along with fear will come panic and tragic losses. I want all my subscribers to be safe and out when the current complacent attitude towards the market turns to fear and panic.

I have explained that a bear market is like a "leaking bucket." The hapless owner of the bucket plugs one hole and another appears to take its place. Meanwhile, the water level in the bucket continues to drop. I have also stated that the best way to gauge the water level is through a series of leading indices.

I now suggest expanding our "leakage barometer" to include six index readings. These are the D-J Industrials, Rails, Utilities, 40 Bonds, advance-delcine ratio and Barron's Low-Priced Stock Index. In a true primary bear market one, two, three or all of these six indicators will continue to probe new low territory. During the worst periods of a bear market, four, five or all of these indicators will sink into new low ground.

The 40 Bonds and to some extent the Utilities reflect monetary conditions. Tightening money will squeeze off any economic boom in due time, and the new lows on both the Utilities and 40 Bonds last week attest to the adverse money condition which have gripped this nation (and the rest of the world, for that matter).

Last week the Rails joined the Utilities in producing new lows as did the advance-decline ratio. On August 15 the A-D ratio broke to a new low for the bear market. On August 16 Industrials sank to a new 1966 low, accompanied by new lows in Rails, Utilities, the A-D ratio and the 40 Bonds. August 16 was, in fact, a total victory for the bears.

One particularly interesting study is the Low-Priced Stocks. Historically, these "cats-and-dogs" tend to be owned by the public and the speculators. Generally there is little real distribution in these stocks prior to the top (in contrast with the long periods of distribution usually seen in high quality issues). Thus, it is characteristic of the Low-Priced Stock Index to strike a spearpoint top during or before a general bull market top. Following the spearpoint, the L-P Stock drops sharply, and the sinking trend in the low-priced issues continues with little respite until the final bear market bottom. In other words, even during upward corrections within the bear market, the low-priced stocks continue to act sluggishly. The reason for this is that as speculative fever wanes, each successive new bear market rally is seen as a change to buy "good stocks" at attractive prices. Therefore, what money is available tends to go into General Motors or American Telephone at "bargain prices." Hupp and Welbilt and Sparton Corp. are forgotten. Why buy "junk" when the blue chips are selling at attractive levels.

Barron's L-P Stock Index hit its 1966 high during the week of April 25 at 248.8. On May 23 this index dropped to a 1966 low of 213.8. Last week (although the figures will not be available until Monday in Barron's) the L-P Stock Index almost surely established a new low for the year.

"How To Make a Long Bear Market" Department: "In times past, such reverses could have set off panic afflicting the nation's entire economy. Perhaps the most remarkable thing about the 1966 market is that even the small-time stock buyer, though uneasy, has refused to panic. Instead, he is playing the game with considerable cool. Says a Milwaukee schoolteacher: 'Most of the people I know who invest have job security. We're only losing profits now. I'm not going to chicken out'." (Time Magazine, August 19).

MONEY: We are undoubtedly seeing a once-in-a-generation phenomenon in the money market. What we are witnessing is the bitter fruit of 30 years of deficit spending, political handouts, and "New Economics"-thinking. Our leaders have spent or given away the wealth of the nation, and when crisis conditions strike a nation's wealth is measured in gold.

The current artificial "cheap money" boom has run out of dollars, and the accompanying newspaper clip attests to that fact (from the New York Times). I have included the U.S. Government Bond quotes for August 16, and this is one to put away to show your grandchildren. Here we see 27 of the bonds at yields of 5% or better with every one of these bonds selling below issue price. Thus the debt of the near-bankrupt U.S. Government is selling at all sorts of substantial discounts from the original issuing price, a sad commentary on the credit of our nation.

Would it all have happened if not for the expense of Viet Nam? Or was Viet Nam or something like it in the cards, a final idiotic blunder by the same politicians and the same type of thinking that has taken this country so far down the road to a major bear market collapse. Let history be the judge. Our job is to stay solvent and protect ourselves against the foolishness and mistakes of our leaders. It is not going to be easy, but remember this. Every disaster ultimately ends, and when the worst is recorded, conditions improve. All my subscribers (I hope) are liquid and in fine shape to withstand the ravages of the bear. Fortune-making opportunities will present themselves when the bear market ends. Those of us who had the patience and foresight to see what was coming should then be in a good position to buy the currently inflated assets of a great boom at a fraction of their present value.

INTEREST RATES SURGE FOR BONDS

Costs Highest in Decades and May Well Continue on Upward Course

U.S. REFUNDING IS CITED

5¼% Rate on Government Issues, a Record Since '21, May Find Competition

By JOHN H. ALLAN

It has been 44 years since Nick Carraway, as all good F. Scott Fitzgerald readers know, "decided to go East and learn the bond business" and, incidentally, meet the great Jay Gatsby.

Finance historians have to go back all the way to Nick Carraway's apprentice days in Wall Street to find interest rates as high as they are now. Further-

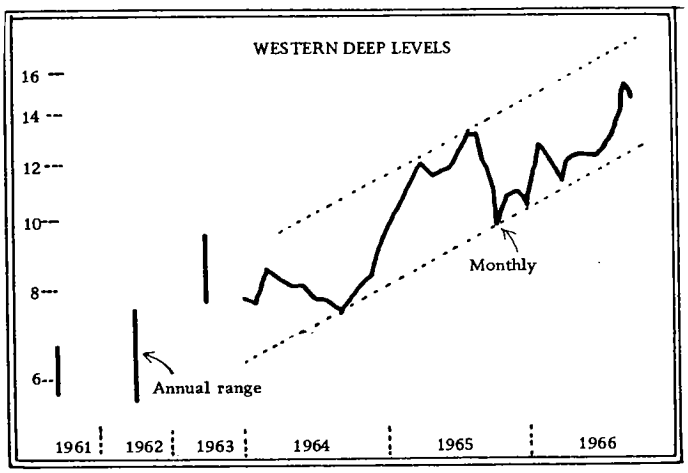
Treasury Bonds

NEW YORK (AP) — Closing over the counter U.S. Government Treasury bonds, bid, asked, net change and yield for Wednesday.

3¾s 66	99.15	99.17	—.1	5.31
2½s 67-62	97.28	98	—.2	5.01
3⅝s 67	97.24	97.28	—.2	5.42
3½s 68	97.2	97.6	—.2	5.59
3¾s 68	96.12	96.16	—.2	5.63
3⅞s 68 Nov	96.10	96.14	—.2	5.59
2½s 68-63	93.24	93.28	—.4	5.34
4s 69 Feb	96.4	96.8	—.2	5.64
2½s 69-64 Jun	92.10	92.14	—.6	5.42
4s 69 Oct	95.10	95.14	—.4	5.60
2½s 69-64 Dec	91.6	91.10	—.6	5.39
4s 70 Feb	94.20	94.24	—.6	5.67
2½s 70-65	90.20	90.24	—.4	5.38
4s 70 Aug	94.4	94.8	—.6	5.65
2½s 71-66	89	89.4	—.6	5.20
4s 71	93.14	93.18	—.8	5.49
3⅞s 71	92.2	92.6	—.12	5.62
4s 72 Feb	92.12	92.16	—.8	5.60
2½s 72-67 Jun	86.6	86.10	—.8	5.27
4s 72 Aug	92.2	92.6	—.8	5.54
2½s 72-67 Sep	85.16	85.20	—.8	5.30
2½s 72-67 Dec	85.6	85.10	—.10	5.26
4s 73	91.2	91.6	—.12	5.54
4⅛s 73	91.20	91.24	—.6	5.53
4⅛s 74	91.18	91.22	—.8	5.49
4¼s 74	92.18	92.22	—.8	5.43
3⅞s 74	89.24	90	—.20	5.39
4s 80	90.4	90.12	—.8	4.99
3½s 80	85.12	85.20	—.8	4.91
3¼s 83-78	81.16	81.24	—.6	4.85
3¼s 85	81	81.8	—.8	4.77
4¼s 85-75	90.16	90.24	—.16	5.03
3½s 90	80.28	81.4	—.12	4.86
4¼s 92-87	89.28	90.4	—.12	4.92
4s 93-88	88.16	89	—.4	4.73
4⅛s 94-89	89	89.8	—.12	4.83
3s 95	79.4	79.12	—.16	4.25
3½s 98	79.24	80	—.16	4.71

Prices quoted in dollars and thirty seconds.

STOCKS: I first recommended Western Deep Levels in Letter 276 (January, 1965), at which time the "B" stock could have been purchased under 10. Last week (see chart) Western Dp. rose to an all-time high of 15¼ bid, a full 50% above the original recommendation price. This giant S. African gold mining property is of premium quality and I continue to recommend it to subscribers who do not yet own it.



Over the past few months the "B" shares have been merged with the "A" shares, and dividends are being paid on both alike. Profits have been expanding steadily for this long-life mine (ore reserves are estimated at over 40 years), and for the first six months of 1965 after-tax profits for Western Dp. rose from $7.3 million to $13.2 million. This is a very impressive performance, and growth is almost guaranteed in the years ahead. Western has the largest known reserves of any gold mine and it is destined ultimately to be the world's largest gold mining operation.

The stock may be bought through American depository receipts, and it is quoted daily in the "Foreign Securities" section of the Wall Street Journal. (Dow Theory Letters, Inc. has a medium-sized position in Western Deep Levels).

Western Dp. has shown a higher yearly range in every year since 1961 with the single exception of 1964. The chart shows the steady upward progress of this stock since 1961. It is my opinion that Western Dp. will be a prime target for purchase by funds and investment interests if and when they deem the gold situation "right for buying."

LATE NOTES: (Written Thursday, August 18, after the opening): As I write this Industrials are going down for the 7th out of 8 trading days. I cannot be sure, but I sense that this market is just on the edge, the very edge of panic. Perhaps important buying will come in again to save it from cracking apart, but if buying does not come in here then the whole structure is apt to split asunder. I feel that the strength and power of this new bear market has not yet been comprehended by the vast majority of investors throughout the nation. Yet think of this: this is the first true primary bear market since the beginning (in June, 1949) of the greatest bull market in world history. The bear is gathering strength, he has been trying to get a death-grip on the throat of the dieing bull. The last vestiges of the bull forces can still be seen in the sporadic convulsions of the "glamor stocks" and "high flyers." But even these groups are now weakening fast. The odds are that the old bull will soon be cold and dead. Then the full tidal force of the bear market will sweep over Wall Street, the nation and the world.